

# European Portfolio Strategist

## How to Play Recovery in Europe

- **Europe on the up** — European macro data is firming. Euro Area PMIs above 50 for 1<sup>st</sup> time since mid-2011. UK data stronger too. Our economists expect end of recession and return to positive (just) GDP growth in 2014E. Light at the end of the tunnel...
- **Delta positive** — Comparing Citi economists' 2014E to 2013E GDP growth forecasts shows the US and the Euro Area with the biggest growth pick-ups. But, this delta (c100bps) is very small compared to 2009-10 (c600 bps) = no monster recovery trade.
- **Recovery trades** — Improving GDP growth in the US & Europe = supportive for equities. We also suggest 6 recovery trades: 1) US recovery, 2) Financials, 3) selective domestic recovery, 4) selective UK recovery, 5) deep value & 6) quant sensitivity.
- **Recovery Trade #1 = US recovery** — US economy is growing > Europe and has similar growth delta over the next 1-2 years. Lower risks, eg political, crisis, financial, also suggest that growth pick-up is more certain. Travel & Leisure is key sector here.
- **Recovery Trade #2 = Financials** — Self-help/restructuring = higher RoEs for Banks & Insurers despite recession. Better growth backdrop would be a bonus. BNP, Barclays, SocGen, ING, Deutsche Bank = restructuring with recovery optionality.
- **Recovery Trade #3 = Domestic recovery** — Growth pick-up is likely to be slow and many risks remain. Be selective is key message. DoMo stocks = domestic exposure and positive relative earnings mo = Allianz, BT, Nordea, ITV, Ryanair, Next.

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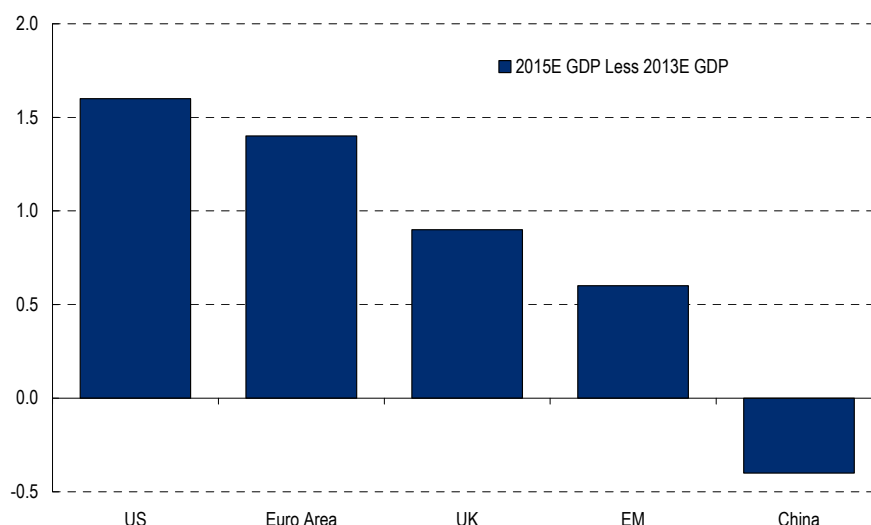
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Figure 1. Delta Positive = US & Europe Set to Enjoy The Highest GDP Delta (2015E vs 2013E)



Source: Citi Research

[18<sup>th</sup> July — Capital Allocators are Coming](#)  
[11<sup>th</sup> July — The Citi Income Report](#)  
[4<sup>th</sup> July — Head-to-Head: Value vs Quality](#)  
[27<sup>th</sup> Jun — Buy the Dip](#)  
[20<sup>th</sup> Jun — UK Equity Strategy](#)  
[13<sup>th</sup> Jun — Pan-Europe Road Ahead 2013](#)  
[6<sup>th</sup> Jun — US Rates & European Equities](#)  
[30<sup>th</sup> May — The Citi Income Report](#)  
[23<sup>rd</sup> May — Mid-Cycle = Earnings Mo](#)  
[16<sup>th</sup> May — European Earnings](#)  
[9<sup>th</sup> May — Buying European Banks](#)

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## How to Play Recovery in Europe

European equities look reasonable value, eg relative to US equities. Euro Area (and UK) macro data is firming, eg PMIs, and recession could soon be yesterday's story. CEO comments from the current results season shows *some* signs of stabilization/improvement in *some* parts of Europe, eg Electrolux, Ford, GE. There is also recent evidence of investor flows into Europe, eg hedge funds.

These are all encouraging supports for our ongoing bullish view on European equities. But, does this mean that it is also time for investors to play a European domestic recovery trade? Here, we think the answer is less clear and we suggest that battles (and stocks) are picked carefully. We are most attracted to those domestic stocks/sectors which are benefitting from self-help/restructuring anyway, eg Financials. Any improvement in the European economy would be a bonus.

Macro getting less bad is one thing (still positive), full-blown recovery is something else. Our economists see plenty of reasons why the latter is unlikely and forecast just 0.2% Euro Area GDP growth in 2014E. This means that a blind recovery trade focusing on domestic recovery plays is risky.

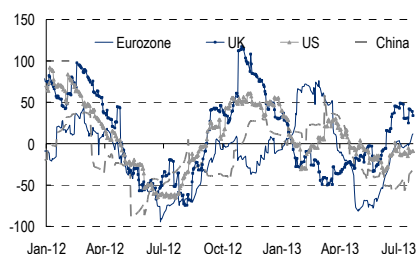
Additionally, there have already been better entry points into various recovery trades in this cycle, such as March 2009, September 2011 and July 2012. Although we are perhaps at the start of a new, and gentle, economic upswing in Europe, share prices and valuations have already been heading higher for 4-5 years. This must take some juice out of any cross-market would-be recovery trade.

Last, beyond broader market support, we suggest six recovery trades in Europe: 1) US recovery, 2) Financials, 3) selective domestic recovery, 4) selective UK recovery, 5) deep value and 6) quant sensitivity. The first four have the advantage of supportive relative earnings trends. Strictly, this makes them momentum themes supported by improving macro trends rather than recovery trades. Deep value could be of interest to longer-term value and contrarian investors. Here, the rewards could be larger, but we would tread more carefully. Last, we show stocks that are most sensitive to improving European/UK GDP according to our Quant team's models.

## Europe stabilizing

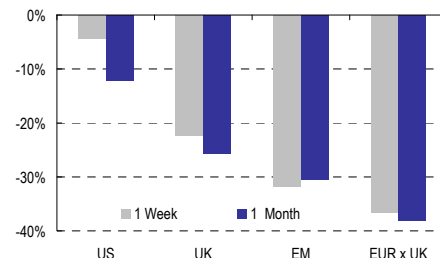
Before looking more closely at the various recovery trades, what can we infer from current macro trends?

Figure 2. CESI (Economic Surprise Index)



Source: Datastream

Figure 3. CERI (Earnings Revisions Index)



Source: Factset, MSCI

In short, the growth outlook in the Euro Area continues to get less bad while the growth outlook in EM continues to get less good. Chinese and Euro Area PMIs highlighted these trends this week. The Euro Area manufacturing PMIs nosed ahead of the 50 level for the first time since mid-2011. It would appear that there is some light at the end of the tunnel.

Citi's Economic Surprise Indicators (CESIs) show similar trends with the Euro Area and the UK ahead of China and also the US. By comparison, the 'better' economic data in Europe is not coming through in Citi's Earnings Revisions Indicators (CERIs). Here, Europe remains a laggard. Analysts are still downgrading estimates.

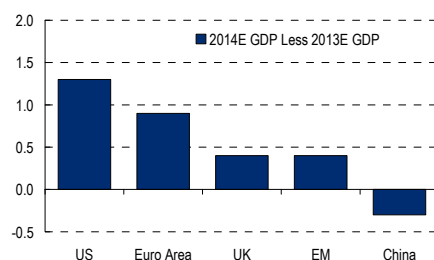
The latest forecast round from Citi's economists is consistent with what we observe in macro data. They lowered growth expectations for China in 2013E and 2014E to sub-7.5% while they raised their forecast for 2014E GDP growth for the Euro Area to +0.2%, from 0%. UK GDP growth expectations have also been revised higher in recent months to c1% this year and a little higher next year. We have two observations here on the European economy: 1) it appears to be stabilizing, 2) do not get carried away into believing that there is a strong recovery around the corner.

Downside risks appear to be reducing, which is a continuation of a process which began last summer with aggressive support from Draghi's "whatever it takes", and this is positive for equity markets. But, our economists would caution against expecting too much too soon from economic growth. Fiscal commitments, headwinds from private sector de-leveraging, high unemployment and weak domestic demand, sluggish external demand including soft global trade, further structural reforms and a resilient euro are some of the reasons why growth is unlikely to pick up sharply.

## Delta positive

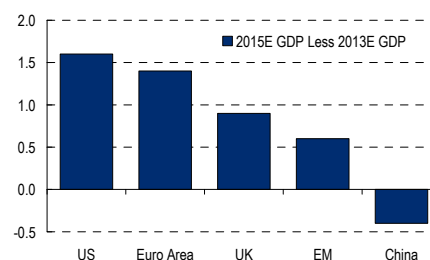
Using our economists' current forecasts, Figure 4 and Figure 5 show the GDP growth delta between 2014E vs 2013E and 2015E vs 2013E respectively.

Figure 4. Regional: 2014E vs 2013E GDP %



Source: Citi Research

Figure 5. Regional: 2015E vs 2013E GDP %



Source: Citi Research

This suggests that it is the US economy that will enjoy the highest GDP delta in the coming 12-18 months, with the Euro Area a close second. These forecasts would be supportive of companies with operations in both regions.

But, this also suggests that investors should not get too carried away on recovery trades currently. A GDP growth delta of c1%, which we expect the US and Euro Area to enjoy, compares unfavourably to the GDP growth delta of 5.5-6% which both regions enjoyed between 2009 and 2010.

That was a proper recovery trade — PMIs doubled from c30 to c60. Now, PMIs around the 50 level are unlikely to breach 55 in the US or in the Euro Area in the next 6-12 months, and or even reach much above the 50 level in the Euro Area, according to our economists. This should temper the extent of any recovery trades.

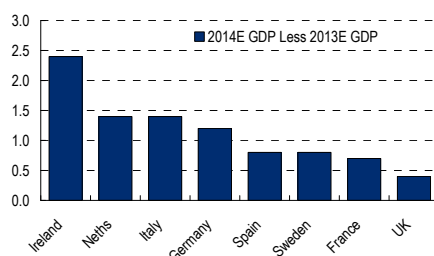
## Looking up for Europe

With PMIs back above 50 and our economists expecting a return to positive GDP growth in 2014E, the future looks less bleak for the European economy. With equity valuations still modest across the region and early signs of improved investor demand/flows, the outlook does look encouraging for European equities.

### 1. GDP delta = positive

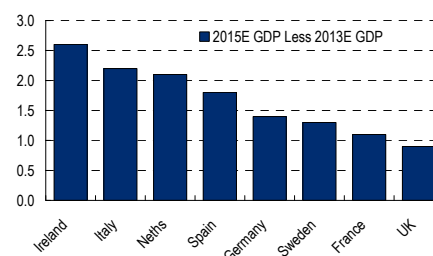
Within Europe, Figure 6 and Figure 7 show the GDP growth delta for selected economies, respectively comparing 2014E vs 2013E and 2015E vs 2013E GDP growth forecasts. Our economists see the biggest improvers over the next one and two years as Ireland, Italy and the Netherlands.

Figure 6. Country: 2014E vs 2013E GDP %



Source: Citi Research

Figure 7. Country: 2015E vs 2013E GDP %



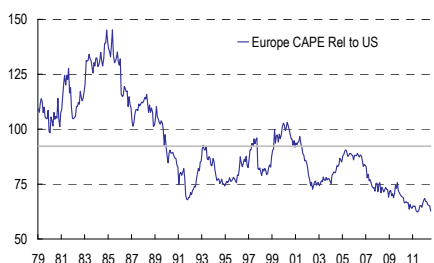
Source: Citi Research

Of these three economies, only Ireland is expected to see 1%+ GDP growth in 2015E (2.2% is the forecast). Again, this suggests an end to recession and a removal of downside risks rather than a strong recovery in many parts of Europe. There is support here, if these forecasts are correct, for European companies with domestic exposure, but we are not expecting a growth explosion.

### 2. Valuation = attractive

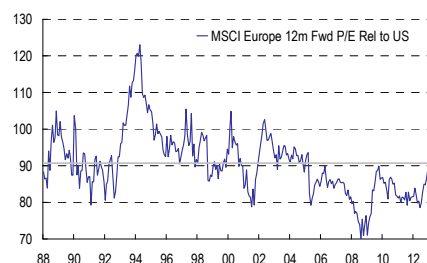
European macro appears to be improving. European equity valuations remain modest. This is a key support of our bull case for the asset class in Europe.

Figure 8. Europe CAPE Relative to US



Source: Datastream

Figure 9. Europe 12m Fwd P/E Rel to US



Source: Datastream

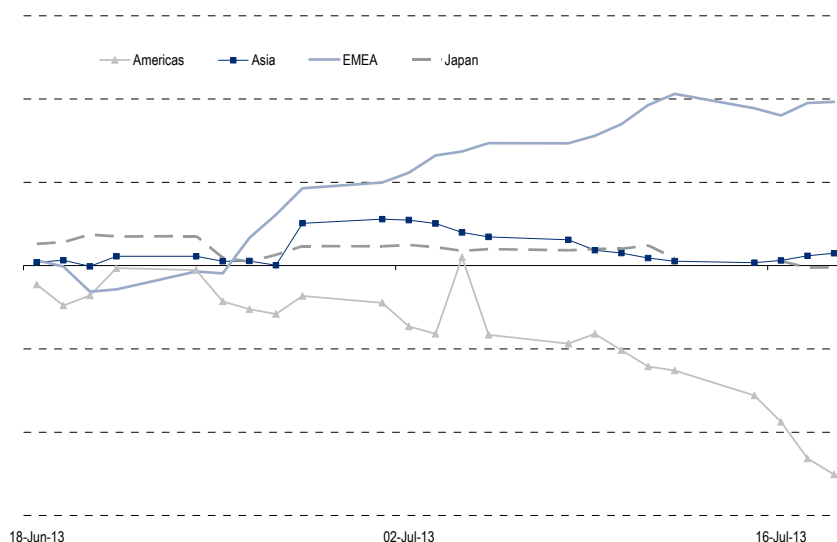
Figure 8 and Figure 9 compares Europe to the US. On a CAPE basis, Europe is at 30-year lows. This suggests an attractive entry point to longer-term investors. On a 12-month forward P/E basis, Europe is close to a 20% discount to the US market. Europe has only traded meaningfully below a P/E relative of 80 once in the last 25 years — during the 2008-09 financial crisis.

Both metrics suggest that Europe offers investors exposure to cheap equity. However, we would also note: 1) the work of our global colleagues showing that it is EM equities, on a 2014E P/E of sub-10x, that is the regional value trade of choice, and 2) our own work suggesting that there are plenty of value traps for investors to avoid in Europe, eg the Offensives = big Oil, Utilities, Food Retail, some Telecoms.

### 3. Flows = signs of life

European equities have looked cheap relative to the US for some time so we would not get wildly excited by this. But, improving macro data married to cheap valuations could be a more attractive combination for some investors.

Figure 10. Cumulative Net Flows By Region (18<sup>th</sup> June to 18<sup>th</sup> July 2013)



Source: GERI; EMEA flow by sector

Figure 10 shows that there has been additional interest in Europe over the last month from hedge funds, funded by net outflows from US positions, according to the aggregated flows through Citi trading desks. One swallow does not make a summer, but this suggests, to us, that some investors are certainly interested in the potential of a recovery (and market catch-up) trade in Europe.

### European recovery trades

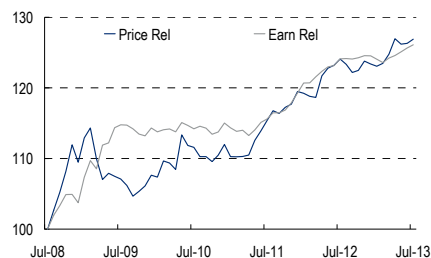
Let's be clear. Life is still not great in Europe. Recession and unemployment are widespread. But, there are some clear signs of improvement, from current accounts to PMIs. Even Spanish unemployment data this week fell for the first time in a couple of years. Overall, our economists believe that we are on a stabilization or gentle, rather than full-blown, recovery path in Europe. This suggests that investors should still tread carefully.

We suggest six recovery trades in Europe: 1) US recovery, 2) Financials, 3) selective domestic recovery, 4) selective UK recovery, 5) deep value and 6) quant sensitivity. Our preferred three are US recovery, Financials and UK recovery.

## 1. US recovery

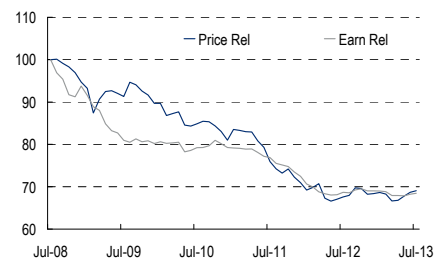
Despite sign of macro improvements in Europe, we would still prefer broader exposure to US economic recovery than to what we think will be a gentle and ultimately modest recovery path in Europe. Additionally, we still see greater risks and higher hurdles to recovery in Europe than in the US. So, both the quantum and quality of recovery appear higher in the US.

Figure 11. US Exposure, P & E Rel



Source: Datastream & Citi Research

Figure 12. Domestic Exposure, P & E Rel



Datastream & Citi Research

Figure 11 and Figure 12 show the price and earnings relative trends for European companies with high US exposure (more than 20% sales/profits) and high domestic exposure (more than 80% sales/profits), respectively.

Price performance has broadly tracked earnings performance over the past five years except in 2009, ie no significant rating change. European companies with US exposure enjoy earnings leadership. We think this is likely to continue with the US economy in recovery mode and expected to enjoy the highest GDP growth delta in the next 1-2 years of all major economies, according to our economists.

This is why we continue to skew our stock and sector models most heavily to the US of all our factors (25% of models).

By contrast, domestically exposed European companies have struggled in both price and earnings terms over the past five years. Recent performance has been less discouraging, tracking sideways over the past 18 months. Will a 'less bad' European economy be enough to support a fresh trend of earnings leadership for these companies? A much stronger than expected European recovery would help. But, we suspect this is unlikely, which suggests that investors should look to be more selective within this group than with US-exposed companies.

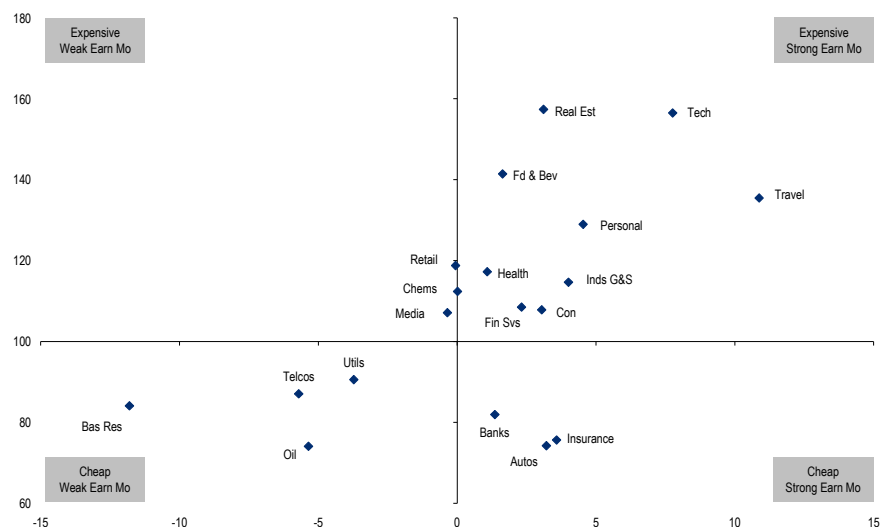
## 2. Financials

European Financials offer investors another recovery trade which we like. We think this is one of the most attractive recovery trades as much of the improvement across this group is being driven by self-help and restructuring in both Banks and Insurers. Both sectors have delivered improving RoE through the past couple of years despite ongoing recession. A more stable macro environment would be a further support.

Figure 13 shows the P/E relative and 6-month relative earnings momentum trends for all European sectors. Banks, Insurance and Autos are the only three sectors that trade on a discount to the market and also have positive relative earnings trends. Financials earnings (and dividends) are already on a recovery path. Our analysts expect these trends to continue over the next 1-2 years. We agree, which is why we continue to run overweight European Financials and would prefer this group to

Cyclicals as Europe's key recovery trade. Cyclicals, generally, are more exposed to Chinese (and EM) growth, ie lower GDP growth delta, trade on higher valuations in absolute terms and relative to their own histories and have less self-help and restructuring to support higher returns than the Financials.

Figure 13. Valuation (P/E Rel, Y-Axis) vs Earnings Trends By Sector (X-Axis)



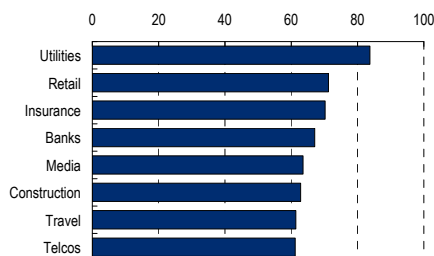
Source: Datastream & Citi Research

At a stock level, our European banks' team highlight the following five stocks which combine self-help and restructuring driven improvement with upside optionality connected to improving economic growth — BNP, Deutsche Bank, Barclays, SocGen and ING.

### 3. Domestic recovery

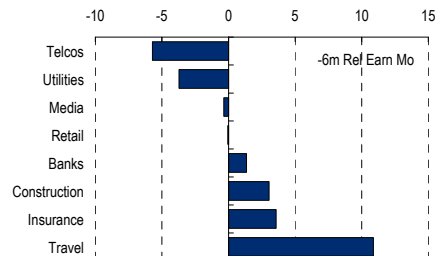
We do believe that growth is stabilizing across Europe. That is a good thing. We do not believe that we are on the cusp of a strong recovery. Therefore, investors should approach the European 'recovery' trade carefully.

Figure 14. Domestic Sales Exposure (Top)



Source: Datastream, Citi Research

Figure 15. Earnings Momentum



Source: Datastream, Citi Research

At a sector level, Figure 14 shows those with above-market European sales exposure. Figure 15 shows how these sectors score on relative earnings momentum over the past six months. Banks, Construction, Insurance and Travel & Leisure have positive trends. We are overweight all except Construction.



Figure 16. DoMo — Domestic Exposure with Positive Earnings Momentum Screen

Stock	RIC	>€5bn		Dom Exp	-6m Rel Earnings Mo	+ve
		Mkt Cap				
Allianz	ALVG.DE	52224		92		8
Lloyds Banking Group	LLOY.L	33903		100		32
BT Group	BT.L	31759		93		4
Nordea Bank	NDA1V.HE	23475		95		8
Assicurazioni Generali	GASI.MI	18571		94		6
Unibail-Rodamco	UNBP.AS	17636		93		9
Svenska Handbkn	SHBa.ST	16186		100		5
SEB A	SEBa.ST	12604		93		16
SCA B	SCAb.ST	12316		96		7
DNB	DNB.OL	11063		100		9
Ryanair Holdings	RYA.I	10055		100		19
Next	NXT.L	8787		99		4
Capita	CPI.L	8113		100		4
Geberit R	GEBN.VX	7748		83		8
Julius Bar Gruppe	BAER.VX	7079		87		15
ITV	ITV.L	6548		92		11
Whitbread	WTB.L	6473		98		5
Ziggo	ZIGGO.AS	5239		100		13
Schindler P	SCHN.S	5212		100		4
Ferrovial	FER.MC	5187		90		26

Source: Datastream, Citi Research

Figure 16 looks for domestically exposure European stocks with positive earnings trends. This is mainly Financial and Consumer stocks.

Figure 17. The Improvers — Domestic Exposure with Improving Earnings Momentum Screen

Stock	RIC	>€5bn		Dom Exp	Current -6m Rel Earn Mo	Previous -6m Rel Earn Mo	Current vs Previous 6m Rel Earn Mo	+ve
		Mkt Cap						
Lloyds	LLOY.L	33903		100	32	15		17
BT Group	BT.L	31759		93	4	-1		5
E.On	EONGn.DE	24312		94	-9	-16		7
GDF Suez	GSZ.PA	23409		85	-3	-11		8
Unicredit	CRDI.MI	19132		98	-6	-17		11
SEB A	SEBa.ST	12604		93	16	11		5
Kingfisher	KGF.L	10427		86	-2	-9		7
Geberit R	GEBN.VX	7748		83	8	1		8
Julius Bar Gruppe	BAER.VX	7079		87	15	-9		24
ITV	ITV.L	6548		92	11	7		4
Ferrovial	FER.MC	5187		90	26	22		5
Bouygues	BOUY.PA	5128		100	-3	-10		7

Source: Datastream, Citi Research

Figure 17 shows domestic “improvers”. We look for stocks with positive earnings delta comparing the current six-month relative earnings trends to the previous six months. This shows that earnings trends have got less negative for E.On, GDF Suez, Unicredit, Kingfisher and Bouygues. Investors looking for signs of recovery in domestic stocks should keep an eye on this “improvers” table.

#### 4. UK recovery

Our economists are a little more optimistic on the UK economy than the Euro Area economy over the coming 12-18 months. Michael Saunders, our UK economist, now expects around 1% GDP growth this year and next year. While growth is still weak, this should provide some support to UK companies with domestic exposure.

Figure 18. UK Exposed UK Stocks

Stock	RIC	>£2bn Mkt Cap	UK Exp	+ve -6m Rel Earn Mo
Barratt Developments	BDEV.L	3334	100	39
Berkeley Gp. Hdq.	BKGH.L	2747	100	13
Hargreaves Lansdown	HRGV.L	2204	100	12
Persimmon	PSN.L	3796	100	26
Lloyds Banking Group	LLOY.L	28579	100	33
Taylor Wimpey	TW.L	3457	99	35
Whitbread	WTB.L	5542	97	5
Next	NXT.L	7500	95	4
ITV	ITV.L	5661	89	11
Capita	CPI.L	6857	100	5
Travis Perkins	TPK.L	4086	100	5

Source: Datastream, Citi Research

Figure 18 shows those UK stocks with high domestic exposure and positive relative earnings trends. Many of these stocks, eg ITV, have enjoyed positive earnings momentum for some time now. Not so much recovery plays but momentum plays.

## 5. Deep value

Equity markets have re-rated over the past 1- and 5-years. The market value opportunities were much stronger last summer and in early 2009 than now. To us, this means that value investors should tread carefully. Value is not as cheap as it was, as shown by our recent report.

Figure 19. Cheap Domestic Exposure Screen

Stock		>€5bn RIC Mkt Cap	Dom Exp	>100 P/B Rel to Trough	-6m Rel Earnings Mo	ND/EBITDA 2013E
Belgacom	BCOM.BR	2368	100	104	-14	1.26
Statoil	STL.OL	17842	86	107	-8	0.23
E.On	EONGn.DE	24312	94	108	-9	2.09
France Telecom	ORAN.PA	14302	80	109	-7	2.31
GDF Suez	GSZ.PA	23409	85	113	-3	2.35
Morrison (Wm)	MRW.L	7618	100	115	-4	2.14
Randgold Resources	RRS.L	4743	100	122	-37	-0.66
Enel	ENEI.MI	14862	83	123	-11	2.75
Bouygues	BOUY.PA	5128	100	124	-3	1.57
RWE	RWEG.DE	10996	89	125	-10	1.75
Banco De Sabadell	SABE.MC	4397	99	126	7	
Tesco	TSCO.L	31172	81	126	-3	1.79
Cairn Energy	CNE.L	1869	100	127	193	22.07
Banco Popular Espanol	POP.MC	4038	100	128	-18	
Terna Rete Elettrica	TRN.MI	4144	100	132	11	4.58
Galp Energia Sgps	GALP.LS	2273	91	142	-10	1.84
Caixabank	CABK.MC	3080	100	145	9	

Source: Datastream, Citi Research

European equities have re-rated despite the lingering crisis and extending recession in Europe. Investors who have placed exaggerated emphasis on Europe's headwinds will have had a rough ride.

But not every stock has had such a strong ride. Figure 19 shows those domestically exposed European stocks which are trading closest to their 2009 price/book trough. This list is dominated by Utility, Telecom and peripheral companies. Deep value investors may find interest in some of these names. Most continue to have negative relative earnings trends. We would tread carefully in the absence of fundamental support in many of these names.

## 6. Quant sensitivity

Figure 20 shows the 20 European ex-UK and UK stocks with the highest betas to improving GDP growth in Europe and the UK, respectively, according to analysis from our Quantitative team.

Figure 20. Stocks with Highest Sensitivity to Improving Euro GDP

Europe ex-UK				UK			
Swedbank A	SWEDa.ST	Societe Generale	SOGN.PA	Glencore Xstrata	GLEN.L	Burberry Group	BRBY.L
Restricted	—	Danske Bank	DANSKE.CO	Lloyds Banking Group	LLOY.L	ITV	ITV.L
Continental	CONG.DE	SEB A	SEBa.ST	GKN	GKN.L	Johnson Matthey	JMAT.L
HeidelbergCement	HEIG.DE	Kering	PRTP.PA	Land Securities Group	LAND.L	GlaxoSmithKline	GSK.L
Infineon Technologies	IFXGn.DE	Restricted	—	Rolls-Royce Holdings	RR.L	Reckitt Benckiser Group	RB.L
Credit Agricole	CAGR.PA	UCB	UCB.BR	Legal & General	LGEN.L	National Grid	NG.L
Fiat	FIA.MI	Henkel Pref.	HNKG_p.DE	Smith & Nephew	SN.L	Whitbread	WTB.L
KBC Groupe	KBC.BR	Safran	SAF.PA	HSBC Holdings	HSBA.L	Unilever (UK)	ULVR.L
Erste Group Bank	ERST.VI	EDF	EDF.PA	Shire	SHP.L	Prudential	PRU.L
ThyssenKrupp	TKAG.DE	Lafarge	LAFF.PA	British Land	BLND.L	Imperial Tobacco Gp.	IMT.L

Source: Datastream, Citi Research

## And finally...

Our analysts suggested five stocks which should benefit from improving economic trends in the UK and Europe over the coming 12-18 months: 1) [DS Smith](#): European packaging stock which typically grows revenues at GDP +1%, 2) [Kingfisher](#): could benefit from the UK government mortgage guarantee scheme and recently stabilizing housing and DIY sales in France, 3) [Bankinter](#): the banks team upgraded their stance on Spanish banks to neutral in June; Bankinter is the preferred name as one of the best capitalised banks in Spain, 4) [Veolia](#): little appears to be priced in for its cost cutting program plus optionality from any economic recovery to provide further upside, 5) [Britvic](#): looks to offer one of the best earnings growth profiles in staples at a reasonable valuation. Our analysts now estimate 25% EPS growth this year and 14% CAGR over 2013-16.

## Strategy outlook

European macro data is improving. The Euro Area manufacturing PMI was above 50 this week for the first time since mid-2011. This is positive, but investors should not get carried away. Yes, our economists expect a positive 2014E vs 2013E GDP growth delta for Europe (and the US). This was c6% in 2009-10 vs c1% for 2013-14E. This 'recovery' is very small by comparison. Recovery trade #1 = buy equities. Our next two preferred recovery trades are: 1) US recovery and 2) Financials.

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## Market Outlook

Our Chief Economist and team expect another year of modest global growth in 2013. De-leveraging should cap growth. Policy action should (successfully, in our view) defuse systemic growth bombs. Despite macro risks, we have argued that the macro framework remains pretty certain and embedded. It consists of five elements: 1) de-leveraging, 2) lower growth, 3) divergent growth, 4) 0% policy rates, and 5) QE. It is this framework that gives us a world of low growth and low rates and is the basis for our ongoing preference for growth and income-biased strategies.

### Macro

GDP	2012	2013E	2014E
Euro zone	-0.5	-0.7	0.2
UK	0.1	0.9	1.3
Global	2.5	2.5	3.1
US	2.2	1.6	2.9
Japan	1.9	2.2	2.0

CPI	2012	2013E	2014E
Euro zone	2.5	1.5	1.3
UK	2.8	2.6	2.2
Global	2.9	3.0	3.2
US	1.8	1.1	1.9
Japan	0.0	0.0	1.9

Interest Rates	3Q13E	1Q14E	3Q14E
ECB	0.50	0.25	0.25
UK Base	0.50	0.50	0.50
US Fed Funds	0.25	0.25	0.25
Japan Call	0.10	0.10	0.10

10Yr Yield	3Q13E	1Q14E	3Q14E
Euro zone	1.55	1.50	1.70
UK	2.20	2.30	2.60
US	2.60	2.80	3.15
Japan	0.90	0.80	0.80

Ex Rates	3Q13E	1Q14E	3Q14E
US\$/€	1.30	1.28	1.31
US\$/£	1.47	1.46	1.49
€/£	0.88	0.88	0.88
Y/US\$	100	109	110

End Year Targets	Now	End-13E	Return
Stoxx	301	330	10
FTSE 100	6572	7000	7

	Mid-14	Return
Stoxx	340	13
FTSE 100	7200	10

	End-14	Return
Stoxx	345	15
FTSE 100	7300	11

Source: Datastream and Citi Research estimates

Modest global growth is the outcome in 2012, but investors have had to deal with Chinese hard landing fears, US stall speed concerns and ongoing uncertainty in the Euro Area. By end-1H13, no Chinese hard landing and no US fiscal cliff should contribute to a world of reduced macro risks. From Europe, Spain (and possibly Italy) in a funding program and getting safely beyond Italian elections could also bring some temporary stability. Lower macro risk in 2013 is one support of our re-rating case and should also present a better platform for corporates to be heard.

### 2014 looks better than 2013 for earnings

Modest nominal global GDP growth including a 2H13E pick-up in US growth and a pick-up in EPS-boosting M&A and buybacks could support modest single-digit earnings growth in 2013E. But recession in the EA and near-record margins suggest that big earnings gains are unlikely. Citi's analysts expect 7% earnings growth in 2013E and 2014E. Our top-down base case is 0-5% & 10%, respectively.

### Equities look fair value to super-cheap

European equities look fair value on trailing P/E and price/book multiples, in-line with long-term averages. Balance sheet adjusted multiples (EV/EBITDA) suggest that shares are cheaper than fair value. Based on post-1980 data, current DY, P/E, price/book and CAPE multiples all suggest 10%+ compound returns over the next 10 years. While, in the absence of an earnings collapse, absolute valuations look supportive of further 2013 gains for European equities, it is relative valuations that continue to show equities as looking particularly cheap. In the UK, dividends have not looked this cheap vs UK gilts in the last 100 years. European equities are trading at record cheaps relative to investment-grade credit.

### Sector Strategy

We continue to run a barbell strategy, with a preference for growth leaders in a low-growth world & cheap (acceptable) risk. We also back restructuring and re-leveraging as key alpha drivers in 2013-14.

Figure 21. European Sector Strategy

Overweight	Neutral	Underweight
Banks	Autos	Chemicals
Basic Resources	Media	Construction
Financial Services		Industrial G&S
Food & Bev		Oil & Gas
Healthcare		Real Estate
Insurance		Retail
Personal & Household Goods		Telecoms
Technology		Utilities
Travel & Leisure		

Source: Citi Research

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## Valuation Tables

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Figure 22. Pan-European Sector Weightings & Returns

As at Close 23 Jul 13	Mkt Cap	% of	Return Relative to DJ Stoxx					Absolute Return			
Sector (No of Stocks)	(Euros m)	J Stoxx	1m	3m	12m	Ytd	1m	3m	12m	Ytd	
Oil & Gas (32)	506,661	8.3	-1	1	-17	-7	6	4	2	2	
Chemicals (24)	309,161	5.0	-3	1	2	-3	4	4	26	6	
Basic Resources (23)	209,102	3.4	1	-4	-24	-25	8	0	-6	-18	
Construction & Materials (21)	132,549	2.2	1	4	6	0	8	7	30	9	
Industrial G&S (102)	663,955	10.8	0	3	5	2	7	6	29	12	
Automobiles & Parts (14)	172,522	2.8	9	19	20	9	16	23	46	20	
Food & Beverage (30)	534,632	8.7	-3	-9	-8	-2	4	-5	13	7	
Personal & H'hold Goods (30)	368,682	6.0	-2	-1	-2	2	5	2	20	12	
Health Care (35)	714,004	11.6	-2	-4	-2	6	4	-1	20	16	
Retail (26)	201,867	3.3	3	1	2	3	10	5	24	13	
Media (27)	152,372	2.5	1	4	7	7	9	7	32	17	
Travel & Leisure (21)	91,328	1.5	-2	3	10	7	5	7	35	17	
Telecommunications (23)	298,832	4.9	1	-1	-13	3	8	3	7	12	
Utilities (26)	242,529	4.0	-3	-4	-11	-6	4	-1	9	2	
Banks (47)	780,014	12.7	3	2	20	0	10	5	47	9	
Insurance (35)	379,860	6.2	3	5	21	6	10	9	49	16	
Real Estate (29)	87,964	1.4	1	-1	-5	-3	8	3	17	6	
Financial Services (31)	96,330	1.6	4	6	16	11	11	10	42	21	
Technology (24)	195,178	3.2	-1	3	9	2	6	6	34	12	
Stoxx - Pan Europe (600)	6,137,542	100.0	—	—	—	—	7	4	23	9	
Pan Euro - Large Cap	4,981,378	81.2	0	0	-1	0	7	3	22	9	
Pan Euro - Mid Cap	801,530	13.1	0	1	4	2	7	5	27	12	
Pan Euro - Small Cap	354,635	5.8	1	2	4	2	8	5	27	11	
Stoxx ex UK - Europe ex UK (419)	4,064,454	66.2	—	—	—	—	7	4	27	10	
EuroStoxx - Eurozone (298)	2,718,857	44.3	—	—	—	—	7	5	29	8	

Source: Citi Research & DataStream

Figure 23. Pan-European Sector Relative Ratings

As at Close 23 Jul 13	P/E Relative to DJ Stoxx				Yield Relative to DJ Stoxx			
Sector	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Oil & Gas	64	74	77	85	132	129	124	118
Chemicals	106	111	114	112	79	79	79	79
Basic Resources	86	100	96	88	110	103	100	99
Construction & Materials	108	109	104	100	98	99	97	95
Industrial Goods & Services	109	113	110	111	80	83	83	83
Automobiles & Parts	60	73	73	69	89	91	90	94
Food & Beverage	134	135	139	141	77	80	80	80
Personal & H'hold Goods	125	126	129	129	75	79	78	81
Health Care	103	109	111	112	91	91	92	91
Retail	115	121	126	129	91	87	84	84
Media	103	110	112	113	113	100	98	95
Travel & Leisure	149	135	121	113	70	63	62	65
Telecommunications	74	83	91	94	148	152	145	143
Utilities	74	87	98	98	187	169	154	144
Banks	137	90	82	76	99	107	122	131
Insurance	79	71	74	77	114	115	112	109
Real Estate	144	144	153	160	117	115	110	106
Financial Services	119	106	108	107	108	102	103	104
Technology	233	172	136	129	56	48	48	49
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	93	96	97	98	103	104	104	103
Pan Euro - Mid Cap	131	122	116	114	90	84	85	86
Pan Euro - Small Cap	190	126	117	110	87	84	84	84
Stoxx ex UK - Europe ex UK	106	102	100	99	99	99	100	101
Stoxx Eurozone - Eurozone	102	98	95	94	103	103	103	103

Source: Citi Research & DataStream



Figure 24. Pan-European Sector Growth

As at Close 23 Jul 13 Sector	Earnings Growth %			Net Dividend Growth %		
	2013E	2014E	2015E	2013E	2014E	2015E
Oil & Gas	-8.5	7.8	0.3	2.0	4.5	3.5
Chemicals	1.4	10.2	13.2	4.0	8.4	8.6
Basic Resources	-8.4	16.7	21.8	-2.9	6.5	7.6
Construction & Materials	5.0	18.5	15.3	5.2	6.5	6.4
Industrial Goods & Services	2.4	15.5	10.2	7.1	8.8	9.2
Automobiles & Parts	-14.0	13.7	16.3	5.3	7.6	13.8
Food & Beverage	5.4	9.2	9.4	7.7	9.6	8.4
Personal & H'hold Goods	5.1	10.4	10.6	9.4	8.0	11.9
Health Care	-0.5	11.4	9.6	4.2	9.1	7.8
Retail	0.4	8.8	7.9	-0.7	5.7	7.5
Media	-0.9	11.7	9.0	-7.9	6.8	5.3
Travel & Leisure	16.9	26.1	18.5	-6.2	6.9	13.5
Telecommunications	-6.1	3.9	7.0	6.5	4.0	7.5
Utilities	-9.7	0.8	10.6	-6.4	-0.4	1.1
Banks	61.0	24.7	18.5	12.2	24.5	16.2
Insurance	18.0	7.7	6.1	4.7	6.0	5.8
Real Estate	6.4	6.3	5.5	2.1	4.7	4.7
Financial Services	19.4	10.7	11.7	-2.5	10.0	9.6
Technology	43.2	43.6	16.7	-10.5	9.2	10.0
Sbxx - Pan Europe	6.0	12.8	10.9	3.9	9.0	8.6
Pan Euro - Large Cap	3.2	11.6	10.2	5.0	8.8	8.5
Pan Euro - Mid Cap	14.0	18.5	13.0	-3.0	10.7	9.1
Pan Euro - Small Cap	59.5	21.9	18.5	1.0	8.1	9.1
Sbxx ex UK - Europe ex UK	9.4	15.5	12.4	4.6	9.9	9.0
Sbxx Eurozone - Eurozone	10.3	15.5	12.4	4.2	9.1	8.3

Source: Citi Research & DataStream

Figure 25. Pan-European Sector Ratings

As at Close 23 Jul 13 Sector	Price/Earnings				Net Dividend Yield			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Oil & Gas	9.1	10.0	9.2	9.2	4.61	4.70	4.91	5.08
Chemicals	15.2	15.0	13.6	12.1	2.77	2.88	3.12	3.39
Basic Resources	12.3	13.5	11.5	9.5	3.84	3.72	3.97	4.27
Construction & Materials	15.4	14.7	12.4	10.8	3.41	3.59	3.82	4.07
Industrial Goods & Services	15.6	15.3	13.2	12.0	2.81	3.01	3.28	3.58
Automobiles & Parts	8.5	9.9	8.7	7.5	3.13	3.29	3.54	4.03
Food & Beverage	19.2	18.2	16.7	15.2	2.70	2.90	3.18	3.45
Personal & H'hold Goods	17.9	17.0	15.4	13.9	2.62	2.87	3.10	3.47
Health Care	14.7	14.8	13.3	12.1	3.19	3.32	3.62	3.91
Retail	16.4	16.3	15.0	13.9	3.18	3.16	3.34	3.59
Media	14.8	14.9	13.4	12.3	3.94	3.63	3.88	4.09
Travel & Leisure	21.3	18.2	14.4	12.2	2.45	2.30	2.46	2.80
Telecommunications	10.6	11.3	10.8	10.1	5.17	5.50	5.72	6.15
Utilities	10.6	11.8	11.7	10.6	6.55	6.13	6.10	6.17
Banks	19.6	12.2	9.8	8.2	3.47	3.89	4.84	5.63
Insurance	11.2	9.5	8.9	8.3	3.99	4.17	4.42	4.68
Real Estate	20.7	19.4	18.3	17.3	4.07	4.16	4.36	4.56
Financial Services	17.1	14.3	12.9	11.6	3.79	3.69	4.06	4.45
Technology	33.4	23.3	16.2	13.9	1.95	1.74	1.90	2.09
Sbxx - Pan Europe	14.3	13.5	12.0	10.8	3.50	3.63	3.96	4.30
Pan Euro - Large Cap	13.4	13.0	11.6	10.5	3.59	3.77	4.10	4.44
Pan Euro - Mid Cap	18.8	16.5	13.9	12.3	3.14	3.04	3.37	3.67
Pan Euro - Small Cap	27.3	17.1	14.0	11.8	3.03	3.06	3.31	3.61
Sbxx ex UK - Europe ex UK	15.1	13.8	12.0	10.6	3.45	3.61	3.97	4.33
Sbxx Eurozone - Eurozone	14.6	13.2	11.4	10.2	3.58	3.73	4.07	4.41

Source: Citi Research & DataStream

Figure 26. Pan-European Country Weightings & Returns

	Mkt Cap (Euros m)	% of Stoxx	Relative Return to Stoxx				Absolute Return			
			1m	3m	12m	YTD	1m	3m	12m	YTD
Austria	24,766	0.4	-1	-5	4	-10	8	-2	29	-1
Belgium	92,293	1.5	-3	-6	-2	-1	6	-3	21	9
Denmark	113,617	1.9	0	-3	-7	-2	10	0	15	8
Finland	82,592	1.3	-1	1	13	2	8	5	40	12
France	908,671	14.8	1	2	7	2	10	6	33	12
Germany	804,559	13.1	0	4	7	1	9	8	32	11
Greece	6,582	0.1	5	-3	11	0	15	0	37	10
Ireland	45,634	0.7	0	-2	-5	4	10	1	18	15
Italy	206,067	3.4	-1	-3	5	-9	9	0	30	0
Netherlands	252,896	4.1	3	5	6	5	12	8	31	15
Norway	86,531	1.4	2	-1	-11	-6	11	3	10	4
Portugal	17,114	0.3	-3	-7	7	-5	6	-4	32	4
Spain	261,008	4.3	0	-5	15	-7	10	-2	43	2
Sweden	300,147	4.9	5	3	0	5	15	6	24	16
Switzerland	845,301	13.8	-1	-2	3	6	8	1	28	16
UK	2,073,088	33.9	-1	-1	-9	-2	8	3	13	8
Stoxx - Pan Europe	6,120,868	100								

Source: Citi Research & DataStream

Figure 27. Pan-European Country Relative Ratings

Country	Price/Earnings				Net Dividend Yield			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Austria	90	103	78	79	90	100	106	108
Belgium	126	118	117	116	102	95	103	103
Denmark	132	122	114	109	54	61	71	74
Finland	152	126	116	115	146	113	108	103
France	110	96	94	93	100	105	106	107
Germany	80	90	90	89	94	88	89	91
Greece	40	85	105	88	136	44	63	128
Ireland	147	154	132	125	45	46	45	43
Italy	101	98	91	91	108	108	107	109
Netherlands	111	108	102	102	73	70	73	71
Norway	83	88	86	88	133	130	132	132
Portugal	1325	138	96	79	140	130	131	133
Spain	120	101	102	101	156	181	171	158
Sweden	107	122	116	116	103	108	108	109
Switzerland	120	113	112	109	88	88	90	92
UK	91	96	100	103	102	101	99	99
EuroStoxx - Eurozone	102	98	95	94	103	103	103	103
Stoxx ex UK - Europe ex UK	106	102	100	99	99	99	100	101
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 28. Pan-European Country Growth

As at Close 23 Jul 13		Earnings Growth %			Dividend Growth %		
Country	2013E	2014E	2015E	2013E	2014E	2015E	
Austria	-7.1	48.9	8.9	15.9	15.0	10.8	
Belgium	13.0	14.0	11.4	-2.7	18.3	8.6	
Denmark	14.0	21.5	16.0	18.4	26.9	11.9	
Finland	27.2	22.6	12.0	-19.6	3.7	3.2	
France	21.4	15.5	11.7	8.3	10.5	9.5	
Germany	-5.7	11.8	13.0	-2.6	10.0	11.8	
Greece	-50.4	-8.8	32.1	-66.5	55.7	121.9	
Ireland	1.1	31.0	17.1	6.8	7.1	4.7	
Italy	9.7	20.5	11.6	4.1	7.4	10.8	
Netherlands	9.2	18.7	11.7	-0.2	14.1	5.2	
Norway	0.0	15.5	8.0	1.7	10.5	8.9	
Portugal	915.8	62.5	35.0	-3.0	9.1	10.5	
Spain	26.1	11.0	11.8	20.5	3.0	0.6	
Sweden	-7.0	17.9	11.1	8.7	9.0	9.8	
Switzerland	13.2	14.0	13.1	3.8	11.6	10.8	
UK	0.2	8.0	7.9	2.5	7.2	7.8	
EuroStoxx - Eurozone	10.3	15.5	12.4	4.2	9.1	8.3	
Stoxx ex UK - Europe ex UK	9.4	15.5	12.4	4.6	9.9	9.0	
Stoxx - Pan Europe	6.0	12.8	10.9	3.9	9.0	8.6	

Source: Citi Research & DataStream

Figure 29. Pan-European Country Ratings

As at Close 23 Jul 13		Price/Earnings				Net Dividend Yield			
Country	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E	
Austria	12.9	13.9	9.3	8.6	3.15	3.64	4.19	4.64	
Belgium	18.0	15.9	14.0	12.5	3.55	3.45	4.09	4.44	
Denmark	18.8	16.5	13.6	11.7	1.88	2.23	2.83	3.16	
Finland	21.7	17.1	13.9	12.4	5.12	4.12	4.27	4.41	
France	15.7	13.0	11.2	10.1	3.51	3.80	4.19	4.59	
Germany	11.4	12.1	10.8	9.6	3.28	3.19	3.51	3.93	
Greece	5.7	11.4	12.6	9.5	4.76	1.60	2.49	5.52	
Ireland	21.0	20.8	15.8	13.5	1.56	1.66	1.78	1.86	
Italy	14.5	13.2	10.9	9.8	3.78	3.93	4.23	4.69	
Netherlands	15.9	14.5	12.2	11.0	2.54	2.53	2.89	3.04	
Norway	11.8	11.8	10.2	9.5	4.63	4.71	5.21	5.67	
Portugal	189.7	18.7	11.5	8.5	4.88	4.74	5.17	5.71	
Spain	17.1	13.6	12.2	10.9	5.45	6.56	6.76	6.80	
Sweden	15.3	16.4	13.9	12.5	3.60	3.91	4.26	4.68	
Switzerland	17.2	15.2	13.4	11.8	3.08	3.19	3.56	3.95	
UK	13.0	12.9	12.0	11.1	3.58	3.67	3.93	4.24	
EuroStoxx - Eurozone	14.6	13.2	11.4	10.2	3.58	3.73	4.07	4.41	
Stoxx ex UK - Europe ex UK	15.1	13.8	12.0	10.6	3.45	3.61	3.97	4.33	
Stoxx - Pan Europe	14.3	13.5	12.0	10.8	3.50	3.63	3.96	4.30	

Source: Citi Research & DataStream

Figure 30. UK Sector Weightings & Relative Returns

As at Close 23 Jul 2013	Mkt Cap £m	% of AllShare	% of Group	Relative return				
				1m	3m	12m	Qtd	Ytd
OIL & GAS (25)	305,670	15.2		-2	1	-16	-1	-5
Oil & Gas Producers (17)	293,614	14.6	96	-2	1	-16	-1	-5
Oil Equip, Serv and Distrib (7)	11,956	0.6	4	1	3	-14	3	-10
BASIC MATERIALS (36)	156,724	7.8		0	-4	-20	4	-26
Chemicals (8)	14,154	0.7	9	-1	4	1	-2	-5
Forestry & Paper (1)	3,371	0.2	2	9	2	38	6	21
Industrial Metals & Mining (4)	901	0.0	1	-11	-29	-57	-1	-60
Mining (23)	138,298	6.9	88	0	-5	-22	5	-28
INDUSTRIALS (109)	196,287	9.7		0	2	10	0	6
Construction & Materials (11)	14,976	0.7	8	-1	-4	-3	-3	-2
Aerospace (9)	47,826	2.4	24	-2	4	13	1	16
General Industrials (6)	13,586	0.7	7	0	3	5	-2	2
Electronic & Electrical Equip (13)	9,324	0.5	5	0	3	5	1	-4
Industrial Engineering (12)	19,349	1.0	10	0	2	16	-1	2
Industrial Transportation (7)	2,612	0.1	1	-2	9	19	-1	12
Support Services (51)	88,615	4.4	45	1	1	10	1	6
CONSUMER GOODS (37)	279,137	13.8		-3	-5	-2	-3	1
Automobiles & Parts (1)	5,535	0.3	2	8	23	36	6	31
Beverages (4)	83,319	4.1	30	0	-6	-1	-1	-1
Food Producers (11)	45,997	2.3	16	-1	-7	6	-3	1
Household Goods & Home Const (13)	47,689	2.4	17	-3	-2	23	-3	13
Leisure Goods (2)	459	0.0	0	-2	18	117	0	36
Personal Goods (4)	8,493	0.4	3	8	8	1	6	7
Tobacco (2)	87,646	4.3	31	-6	-7	-17	-5	-6
HEALTH CARE (13)	148,617	7.4		-2	-4	-5	-3	7
Health Care Equip & Services (5)	8,216	0.4	6	-2	1	-3	0	0
Pharmaceuticals & Biotech (8)	140,401	7.0	94	-2	-4	-5	-3	7
CONSUMER SERVICES (83)	209,849	10.4		2	5	13	1	8
Food & Drug Retailers (7)	45,761	2.3	22	3	-1	-2	4	1
General Retailers (22)	39,106	1.9	19	6	15	30	4	15
Media (22)	58,717	2.9	28	0	4	10	-1	6
Travel & Leisure (32)	66,266	3.3	32	1	4	19	-1	11
TELECOMMUNICATIONS (8)	127,500	6.3		2	1	-3	-2	15
Fixed-Line Telecoms (6)	30,536	1.5	24	2	12	25	3	24
Mobile Telecoms (2)	96,965	4.8	76	1	-2	-9	-3	12
UTILITIES (7)	76,665	3.8		-1	-5	-4	-2	-1
Electricity (2)	17,832	0.9	23	0	-1	-2	-1	0
Gas, Water & Multi-Utilities (5)	58,833	2.9	77	-2	-6	-5	-2	-1
TECHNOLOGY (23)	31,088	1.5		3	-2	17	2	4
Software & Computer Serv (14)	14,616	0.7	47	3	9	10	1	9
Technology Hardware & Equip (9)	16,472	0.8	53	4	-11	27	3	-1
TOTAL NON-FINANCIAL (341)	1,531,538	75.9		-1	-1	-4	-1	-1
FINANCIALS (261)	485,332	24.1		2	3	18	3	3
Banks (6)	243,530	12.1	50	3	3	24	2	1
Non-Life Insurance (11)	19,406	1.0	4	-3	0	1	-4	-2
Life Insurance (10)	78,007	3.9	16	3	4	24	2	8
Real Estate Inv. Servs (22)	9,358	0.5	2	1	9	20	1	16
REITS (16)	30,583	1.5	6	1	3	1	3	1
Financial Services (26)	39,956	2.0	8	6	4	28	4	15
FTSE ALL SHARE (602)	2,016,869	100.0		0	0	0	0	0
FTSE 100 (100)	1,685,624	83.6		0	-1	-2	-1	-1
Mid 250 (250)	282,315	14		1	3	11	3	5
Small Cap (252)	48,931	2		-1	2	11	2	3

Source: Citi Research & DataStream

Figure 31. UK Relative Ratings

As at Close 23 Jul 2013	P/E Relative				Yield Relative			
	2012E	2013E	2014E	2015E	2012E	2013E	2014E	2015E
OIL & GAS	72	75	76	82	114	117	112	107
Oil & Gas Producers	71	74	76	82	116	119	114	108
Oil Equip, Serv and Distrib	106	95	89	87	75	78	83	86
BASIC MATERIALS	82	101	99	87	100	101	101	102
Chemicals	129	130	132	128	66	67	67	70
Forestry & Paper	120	103	97	102	73	83	89	85
Industrial Metals & Mining	-45	-73	-	-150	39	19	17	16
Mining	77	98	95	83	105	105	105	106
INDUSTRIALS	121	120	119	116	75	77	74	74
Construction & Materials	116	144	119	105	115	113	108	103
Aerospace	110	105	110	111	79	78	77	77
General Industrials	104	103	101	101	85	87	88	87
Electronic & Electrical Equip	126	124	124	123	61	62	62	63
Industrial Engineering	129	122	120	120	65	65	65	64
Industrial Transportation	117	110	106	105	74	74	72	69
Support Services	131	129	127	123	69	72	67	69
CONSUMER GOODS	132	127	127	125	85	89	89	92
Automobiles & Parts	95	93	90	87	63	67	72	77
Beverages	156	149	147	145	63	65	66	66
Food Producers	147	139	139	136	81	85	85	85
Household Goods & Home Const	140	131	128	126	64	81	77	87
Personal Goods	168	154	147	145	53	56	59	61
Tobacco	108	107	108	107	123	124	124	126
HEALTH CARE	90	100	105	107	121	119	115	112
Health Care Equip & Services	121	119	117	116	60	60	62	62
Pharmaceuticals & Biotech	89	99	104	106	124	123	118	114
CONSUMER SERVICES	117	116	114	115	85	82	80	79
Food & Drug Retailers	90	99	110	118	113	108	101	95
General Retailers	126	123	121	119	71	71	71	72
Media	114	114	113	111	83	84	85	84
Travel & Leisure	143	128	116	114	77	69	67	67
TELECOMMUNICATIONS	95	99	100	99	148	132	125	125
Fixed-Line Telecoms	104	106	100	95	85	90	95	122
Mobile Telecoms	93	97	100	100	167	145	135	125
UTILITIES	110	113	115	117	144	138	134	131
Electricity	99	112	113	112	149	136	131	130
Gas, Water & Multi-Utilities	114	113	116	119	142	139	135	131
TECHNOLOGY	197	184	175	166	37	40	44	48
Software & Computer Serv	147	148	146	142	53	54	56	57
Technology Hardware & Equip	281	233	214	196	22	28	34	40
TOTAL NON-FINANCIAL	99	103	103	103	102	101	99	98
FINANCIALS	105	91	90	89	93	95	105	109
Banks	103	83	81	80	82	89	106	114
Non-Life Insurance	83	82	84	85	161	138	134	131
Life Insurance	89	92	94	95	109	105	104	103
Real Estate Inv. Servs	212	212	207	196	50	53	53	54
REITS	187	193	196	198	100	97	94	91
Financial Services	128	100	100	97	105	96	103	106
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	98	98	98	98	103	104	104	104
Mid 250	119	120	120	117	79	74	76	77
Small Cap	124	113	103	94	80	77	77	77

Source: Citi Research & DataStream

Figure 32. UK Sector Growth

As at Close 23 Jul 2013	Earnings Growth %			Net Dividend Growth %		
	2013E	2014E	2015E	2013E	2014E	2015E
OIL & GAS	0.6	7.5	-0.2	9.5	3.5	2.6
Oil & Gas Producers	0.1	7.3	-0.6	9.5	3.2	2.3
Oil Equip, Serv and Distrib	17.4	15.1	10.4	11.1	14.0	11.9
BASIC MATERIALS	-15.4	11.6	22.6	7.3	8.4	8.4
Chemicals	3.7	7.8	10.9	8.1	8.5	12.7
Forestry & Paper	22.1	15.7	3.1	20.9	15.7	3.1
Industrial Metals & Mining	-36.4	-	-	-48.5	0.1	0.0
Mining	-17.3	11.5	23.7	7.2	8.3	8.2
INDUSTRIALS	5.9	10.2	10.1	8.8	3.9	7.5
Construction & Materials	-15.4	32.0	22.1	4.9	2.6	3.2
Aerospace	9.6	3.7	7.2	6.3	6.3	6.5
General Industrials	6.4	11.1	8.0	9.5	8.9	6.5
Electronic & Electrical Equip	6.0	9.2	8.7	7.9	8.4	8.6
Industrial Engineering	11.0	10.0	8.0	6.7	7.1	6.9
Industrial Transportation	11.3	13.6	8.9	7.7	4.0	4.3
Support Services	6.3	11.0	10.9	11.8	0.8	9.7
CONSUMER GOODS	8.9	9.5	9.5	12.4	7.4	11.1
Automobiles & Parts	7.8	12.8	11.2	15.0	15.0	15.0
Beverages	10.0	10.3	9.7	9.2	9.1	8.7
Food Producers	10.8	9.3	9.6	12.2	7.2	8.8
Household Goods & Home Cor	11.4	11.8	10.1	35.2	2.5	21.3
Personal Goods	14.4	13.7	9.7	14.4	13.4	10.6
Tobacco	6.2	7.5	8.9	7.6	7.9	9.6
HEALTH CARE	-6.3	4.6	5.9	5.6	3.9	4.4
Health Care Equip & Services	5.7	11.0	8.5	6.9	10.6	7.8
Pharmaceuticals & Biotech	-6.8	4.2	5.7	5.6	3.7	4.3
CONSUMER SERVICES	5.5	10.4	7.6	2.7	5.6	5.8
Food & Drug Retailers	-5.2	-1.6	0.4	1.8	1.6	1.0
General Retailers	7.3	11.2	9.7	7.1	8.5	8.2
Media	4.7	10.2	9.7	9.1	8.3	7.3
Travel & Leisure	16.9	20.8	9.7	-4.9	5.2	7.7
TELECOMMUNICATIONS	1.2	7.8	9.0	-4.4	2.3	7.1
Fixed-Line Telecoms	2.9	14.5	14.1	13.2	13.7	38.7
Mobile Telecoms	0.7	5.8	7.4	-7.3	0.1	0.1
UTILITIES	2.1	6.6	6.6	2.9	4.5	5.1
Electricity	-7.1	7.8	9.5	-2.6	4.1	7.0
Gas, Water & Multi-Utilities	5.3	6.2	5.7	4.7	4.6	4.5
TECHNOLOGY	12.1	14.2	13.9	18.1	18.4	15.8
Software & Computer Serv	3.8	11.0	10.9	10.1	11.2	9.0
Technology Hardware & Equip	26.3	18.6	17.9	34.7	30.5	25.5
TOTAL NON-FINANCIAL	0.4	8.6	7.6	6.3	5.0	6.4
FINANCIALS	21.6	10.0	8.6	8.5	19.0	12.1
Banks	30.7	11.4	9.0	16.7	28.2	15.5
Non-Life Insurance	6.8	5.8	7.1	-8.8	5.4	5.1
Life Insurance	0.9	6.8	6.7	2.5	7.0	7.1
Real Estate Inv. Servs	4.6	11.8	13.6	13.9	7.7	10.0
REITS	1.8	6.9	7.2	3.6	4.0	4.1
Financial Services	34.1	9.8	10.8	-2.0	15.1	11.3
FTSE ALL SHARE	4.7	9.0	7.9	6.8	7.9	7.7
FTSE 100	4.8	8.8	7.4	7.5	7.6	7.6
Mid 250	3.2	9.1	10.8	0.7	10.6	8.2
Small Cap	15.5	18.8	18.8	3.9	6.8	7.9

Source: Citi Research & DataStream

Figure 33. UK Sector Ratings

As at Close 23 Jul 2013	Price/Earnings				Net Dividend Yield			
	2012E	2013E	2014E	2015E	2012E	2013E	2014E	2015E
OIL & GAS	9.8	9.7	9.0	9.1	3.86	4.23	4.38	4.49
Oil & Gas Producers	9.6	9.6	9.0	9.0	3.92	4.29	4.43	4.53
Oil Equip, Serv and Distrib	14.4	12.3	10.6	9.6	2.54	2.83	3.22	3.61
BASIC MATERIALS	11.1	13.1	11.8	9.6	3.38	3.63	3.94	4.27
Chemicals	17.5	16.9	15.6	14.1	2.23	2.41	2.61	2.94
Forestry & Paper	16.3	13.4	11.6	11.2	2.47	2.99	3.46	3.57
Industrial Metals & Mining	-6.1	-9.5	-	-16.6	1.31	0.67	0.67	0.67
Mining	10.5	12.6	11.3	9.2	3.54	3.79	4.10	4.44
INDUSTRIALS	16.5	15.5	14.1	12.8	2.55	2.77	2.88	3.09
Construction & Materials	15.8	18.6	14.1	11.6	3.89	4.08	4.19	4.32
Aerospace	14.9	13.6	13.1	12.2	2.67	2.83	3.01	3.21
General Industrials	14.2	13.3	12.0	11.1	2.88	3.15	3.43	3.66
Electronic & Electrical Equip	17.0	16.1	14.7	13.5	2.07	2.23	2.42	2.63
Industrial Engineering	17.5	15.7	14.3	13.3	2.21	2.36	2.53	2.70
Industrial Transportation	15.9	14.3	12.6	11.5	2.49	2.69	2.79	2.91
Support Services	17.7	16.7	15.0	13.6	2.33	2.60	2.62	2.88
CONSUMER GOODS	18.0	16.5	15.1	13.8	2.87	3.23	3.47	3.85
Automobiles & Parts	13.0	12.0	10.7	9.6	2.12	2.44	2.80	3.22
Beverages	21.2	19.3	17.5	15.9	2.14	2.34	2.55	2.78
Food Producers	20.0	18.0	16.5	15.0	2.74	3.07	3.29	3.58
Household Goods & Home Co	19.0	17.0	15.2	13.8	2.16	2.92	2.99	3.63
Personal Goods	22.8	19.9	17.5	16.0	1.78	2.04	2.31	2.55
Tobacco	14.7	13.9	12.9	11.8	4.16	4.47	4.82	5.29
HEALTH CARE	12.2	13.0	12.4	11.8	4.08	4.31	4.48	4.68
Health Care Equip & Services	16.4	15.5	13.9	12.8	2.03	2.17	2.40	2.59
Pharmaceuticals & Biotech	12.0	12.9	12.4	11.7	4.20	4.44	4.60	4.80
CONSUMER SERVICES	15.8	15.0	13.6	12.6	2.88	2.96	3.13	3.31
Food & Drug Retailers	12.2	12.8	13.0	13.0	3.82	3.89	3.95	3.99
General Retailers	17.2	16.0	14.4	13.1	2.40	2.56	2.78	3.01
Media	15.5	14.8	13.4	12.2	2.79	3.04	3.30	3.54
Travel & Leisure	19.4	16.6	13.7	12.5	2.61	2.48	2.61	2.81
TELECOMMUNICATIONS	12.9	12.8	11.9	10.9	4.99	4.77	4.88	5.23
Fixed-Line Telecoms	14.1	13.7	12.0	10.5	2.87	3.25	3.70	5.13
Mobile Telecoms	12.6	12.5	11.8	11.0	5.66	5.25	5.25	5.26
UTILITIES	15.0	14.6	13.7	12.9	4.86	5.00	5.22	5.49
Electricity	13.5	14.5	13.5	12.3	5.03	4.90	5.10	5.46
Gas, Water & Multi-Utilities	15.5	14.7	13.8	13.1	4.80	5.03	5.26	5.50
TECHNOLOGY	26.7	23.8	20.9	18.3	1.24	1.46	1.73	2.00
Software & Computer Serv	20.0	19.2	17.3	15.6	1.78	1.96	2.18	2.37
Technology Hardware & Equip	38.2	30.2	25.5	21.6	0.76	1.02	1.33	1.67
TOTAL NON-FINANCIAL	13.4	13.3	12.3	11.4	3.44	3.66	3.84	4.09
FINANCIALS	14.3	11.8	10.7	9.8	3.16	3.43	4.08	4.57
Banks	14.0	10.7	9.6	8.8	2.76	3.22	4.13	4.77
Non-Life Insurance	11.3	10.6	10.0	9.3	5.45	4.96	5.23	5.50
Life Insurance	12.1	12.0	11.2	10.5	3.69	3.78	4.05	4.33
Real Estate Inv. Servs	28.8	27.5	24.6	21.7	1.68	1.92	2.07	2.27
REITS	25.4	25.0	23.4	21.8	3.39	3.51	3.65	3.80
Financial Services	17.4	13.0	11.8	10.7	3.54	3.47	3.99	4.45
FTSE ALL SHARE	13.6	13.0	11.9	11.0	3.38	3.61	3.89	4.19
FTSE 100	13.2	12.6	11.6	10.8	3.49	3.75	4.04	4.35
Mid 250	16.1	15.6	14.3	12.9	2.67	2.69	2.97	3.22
Small Cap	16.8	14.6	12.3	10.3	2.69	2.80	2.99	3.22

Source: Citi Research & DataStream

Figure 34. Companies Mentioned

Stock	RIC	Price	Rating	Currency	Stock	RIC	Price	Rating	Currency
Allianz	ALVG.DE	117.60	1	EUR	Lafarge	LAFP.PA	48.70	1	EUR
Julius Baer	BAER.VX	41.46	2	CHF	Land Secs Group	LAND.L	9.39		GBP
Belgacom	BCOM.BR	16.75	2	EUR	Legal & General	LGEN.L	1.88	2	GBP
Barratt Devs	BDEV.L	3.39	2H	GBP	Lloyds Banking Grp	LLOY.L	0.69	2	GBP
Berkeley Grp	BKGH.L	22.03	2	GBP	Morrison (Wm)	MRW.L	2.86	2	GBP
Bankinter	BKT.MC	3.22	1	EUR	Nordea	NDA1V.HE	9.65	1	EUR
Barclays	BARC.L	3.22	1	GBP	National Grid	NG.L	7.64	2	GBP
British Land	BLND.L	6.00		GBP	Next Grp	NXT.L	48.34	1	GBP
Bouygues	BOUY.PA	21.82	2	EUR	Orange Fr	ORAN.PA	7.39	3	EUR
Burberry Grp	BRBY.L	14.88	2	GBP	Banco Popular	POP.MC	3.00	3H	EUR
BT Grp	BT.L	3.33	1	GBP	Kering	PRT.PA	165.80	1	EUR
Britvic	BVIC.L	5.16	1	GBP	Prudential	PRU.L	11.56	1	GBP
BNP	BNPP.PA	47.76	1	EUR	Persimmon	PSN.L	12.55	1	GBP
CaixaBank	CABK.MC	2.73	2H	EUR	Reckitt Benckiser	RB.L	46.79	1	GBP
Credit Agricole	CAGR.PA	7.31	1	EUR	Rolls-Royce	RR.L	12.21	1	GBP
Cairn	CNE.L	2.70	2H	GBP	Randgold Resourc	RRS.L	46.52	2	GBP
Continental	CONG.DE	118.05	1	EUR	RWE	RWEG.DE	23.35	2	EUR
Capita Grp	CPI.L	10.00	1	GBP	Ryanair	RYA.I	7.37	1	EUR
Deutsche Bank	DBGn.DE	35.98	1	EUR	Bco de Sabadell	SABE.MC	1.54	3H	EUR
UniCredit	CRDI.MI	4.02	2H	EUR	Safran	SAF.PA	42.86	1	EUR
Danske Bank	DANSKE.CO	106.90	1	DKK	Cellulosa	SCAb.ST	172.80		SEK
DnB	DNB.OL	97.90	2	NOK	Schindler	SCHN.S	128.90	2	CHF
EDF	EDF.PA	20.34	2	EUR	SE Banken AB	SEBa.ST	72.05	2	SEK
Enel	ENEI.MI	2.49	1	EUR	SHB	SHBa.ST	294.40	2	SEK
E.ON	EONGn.DE	12.76	3	EUR	Shire	SHP.L	22.89	1	GBP
Erste Bank	ERST.VI	22.03	2H	EUR	DS Smith	SMDS.L	2.43	1	GBP
Ferrovial	FER.MC	13.11	1	EUR	Smith & Nephew	SN.L	7.83	1	GBP
Fiat	FIA.MI	6.11	3	EUR	Societe Generale	SOGN.PA	29.99	1	EUR
Galp Energia	GALP.LS	12.12	1	EUR	Statoil	STL.OL	130.40	2	NOK
Generali	GASI.MI	14.33	3	EUR	Swedbank	SWEDa.ST	155.90	2	SEK
Geberit	GEBN.VX	245.60	3	CHF	ThyssenKrupp	TKAG.DE	17.29	2	EUR
GKN	GKN.L	3.28	1	GBP	Travis Perkins	TPK.L	16.98	1	GBP
Glencore Xstrata	GLEN.L	2.81	1	GBP	TERNA	TRN.MI	3.24	3	EUR
GlaxoSmithKline	GSK.L	16.82	1	GBP	Tesco	TSCO.L	3.64	3	GBP
GDF Suez	GSZ.PA	16.01	1	EUR	Taylor Wimpey	TW.L	1.07	2	GBP
HeidelbergCement	HEIG.DE	55.39	1	EUR	UCB SA	UCB.BR	43.42	2	EUR
Henkel	HNKG_p.DE	73.50	2	EUR	Unilever	ULVR.L	26.72	2	GBP
Hargreaves Lansdown	HRGV.L	9.70	3	GBP	UNIBAIL-RODAMCO	UNBP.AS	185.20		EUR
HSBC	HSBA.L	7.31	1	GBP	Veolia Environment	vie.pa	9.75	1	EUR
Infineon	IFXGn.DE	7.15	1	EUR	Whitbread	WTB.L	31.58	2	GBP
ING	ING.AS	7.637	1	EUR	Ziggo	ZIGGO.AS	27.50	2	EUR
Imperial Tobacco	IMT.L	21.77	2	GBP					
ITV	ITV.L	1.57	1	GBP					
Johnson Matthey	JMAT.L	27.58	2	GBP					
KBC	KBC.BR	30.89	1	EUR					
Kingfisher	KGF.L	3.93	1	GBP					

Source: Citi Research



## Notes

## Notes

## Appendix A-1

### Analyst Certification

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